

2006 TAX LAW CHANGES TO QUALIFIED ZONE ACADEMY BONDS

H.R. 6111 was enacted in late 2006. It provides allocations for Qualified Zone Academy Bonds (QZABs) for 2006 and for 2007. In addition, it makes certain changes in the nature of the investment and expenditure of QZAB proceeds, including funds set aside for payment of debt service on the QZABs. The following is a summary of these changes:

(1) The school district issuing the QZABs (the Issuer) must reasonably expect at the time of issuance of the QZABs, (i) that 95% of the QZAB proceeds will be spent for qualified purposes within five years of issuance, (ii) that a binding commitment to spend at least 10% of the proceeds will be incurred within six months of issuance and (iii) that the project will proceed with due diligence to completion and the proceeds will be spent with due diligence. In general, proceeds not spent within the 5 years must be used to redeem the related QZABs, unless an extension is obtained from the IRS, with said extension request being submitted to the IRS prior to the expiration of the 5 year period.

(2) QZAB proceeds deposited into a project fund are now subject to arbitrage and rebate requirements, currently applicable on governmental tax-exempt bonds. Such QZAB proceeds may not be invested at a yield greater than the yield on the QZABs, which is assumed to be the interest rate on the actual QZAB, often 0%, and any excess earnings must be rebated to the United States. The Internal Revenue Code contains many different types of exceptions from the arbitrage rebate exception on project funds for tax-exempt bonds. Currently it is not clear whether these exceptions will be available for QZAB project proceeds or how they will be applied. Although one needs to assume that these exceptions are not available. Hopefully, with IRS clarification, the benefits of these exceptions (small issuer, two year construction, etc.) will be applied to QZABs and allow most QZAB issuers to invest the project fund at an unrestricted yield for a three or five year period and retain the earnings. It is possible that the IRS may clarify how the yield is computed and allow for higher yield that takes into account the tax credit nature of the QZABs.

(3) Absent further clarification by the IRS, amounts that are deposited in a sinking fund which secures, or is expected to be used to pay, the QZABs

(such as the investment account typically invested under a forward delivery agreement provided by a bank) at final maturity are treated as proceeds of the QZABs and are subject to arbitrage and rebate requirements (same yield and rebate requirements as described above). Although an exemption from rebate may be available for project proceeds of the QZAB, there is no rebate or arbitrage exemption for such a sinking fund and such amounts and any investment earnings on such a sinking fund invested at a yield greater than the QZAB yield (probably 0%) will need to be paid to the United States. Any forward delivery agreement or other investment contract would also need to comply with the extensive IRS requirements for bidding investment contracts, including the need for three bids and the use of the best of said three bids.

(4) Amounts in a QZAB annual debt service fund (unlike a sinking fund payable at maturity as described above) will also be subject to arbitrage and rebate restrictions, but it is anticipated that the exception for a “bona fide debt service fund” applied to pay off QZAB debt, maturing each year, will be available so that any actual restrictions should be minimal or non-existent.

(5) Issuers of QZABs must file reports with the IRS similar to the Form 8038-G filed by issuers of tax-exempt bonds.

(6) The new restrictions apply to QZABs issued after enactment of H.R. 6111 pursuant to calendar year 2006, and thereafter, allocations.